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# FARM PROPERTY AND TRUSTS

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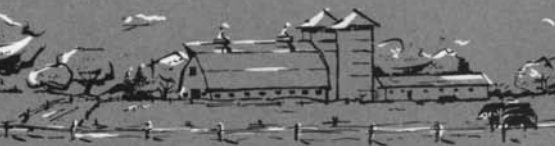


UNIVERSITY OF ILLINOIS COLLEGE OF AGRICULTURE EXTENSION SERVICE IN AGRICULTURE AND HOME ECONOMICS

# FARM PROPERTY AND TRUSTS

*Farm-estate planning is becoming increasingly more complicated. If the farmer is to manage his title and income interests effectively, he must be aware of the various legal tools at his disposal, and have the knowledge with which to select these tools. One legal tool that can be of use to the farmer is the trust. This circular will help you to understand the nature of trusts and their application to farm estates.*

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## WHAT IS A TRUST?

A trust is a written agreement by which an owner of property (the *trustor*) transfers his title to a *trustee* for the benefit of persons called *beneficiaries*. The trustee may be a person or persons, a corporation, or a combination of the two. If a person establishes a trust during his lifetime, it is possible to name himself as trustee and even a beneficiary. If he names himself as both trustee and *sole* beneficiary, however, a trust does not exist.

Many trusts are written into wills, and go into effect at death. In such cases, a person may change the provisions of the trust at any time simply by making a new will. Or the trust may be cancelled completely by leaving it out of a newly drafted will. Since a will-trust does not go into effect until the death of the owner, there is no tax saving in his estate. However, savings are usually made in the future estates of others who have an interest in the trust property.

A will can also be used to add property to a trust that was established during the trustor's lifetime. For example, an owner can place a portion of his estate in trust, and then have the balance of the estate (or any part of it) pass into trust upon his death.

A trust can continue for any period of time set by the owner — for a lifetime, until a child reaches 25, until a spouse remarries, etc. The period is set out in the trust agreement or in a will. If the trust is to extend beyond a lifetime, certain legal limitations may apply. Your attorney can interpret these limitations for you.

Any kind of property can be placed in a trust, including both personal property and real estate. Usually only income-producing property or property that can be sold and the proceeds invested by the trustee is placed in trust. There is no minimum or maximum on the value of this property.

**Beneficiaries do not hold title to the property** (the trustee has title), and they may or may not have possession of the property, depending upon the terms of the trust. Beneficiaries have an equitable interest, however, and are entitled to the benefits of trust income or principal.

**The benefits are set out in the trust agreement**, and the trustee must follow the directions for payment. For example, a trust for a grandchild might require that income be used only for the child's college education, with any extra accumulation of income to be paid by the trustee to the boy or girl at the age of 21. Or a will-trust could require that all income be paid to a surviving wife, that on her death the income be used for minor children, and that the trust be terminated when the youngest child reaches the age of 21.

**An important advantage of the trust** is its flexibility. The trustor can place all kinds of requirements and restrictions in a trust, and a separate trustee can be named to carry out the trust terms. For these reasons, a trust is a much more flexible device for transferring property than certain other legal devices such as a life estate or custodian agreement.

**Lifetime trusts can be made revocable or irrevocable.** This means that the trustor can reserve the power to terminate the trust anytime he wishes, or he can make it binding on himself for the term of the trust.

The *revocable* trust will not reduce inheritance taxes for the trustor under current tax laws. These trusts are useful, however, to obtain professional investment guidance; to secure good management in case of illness, accident, or mental incapacity; to avoid probate costs; to provide flexibility in using insurance proceeds paid to the trust; and other uses. A revocable trust can be drawn that will continue to operate after the death of

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the owner who placed his property in trust, and there may be substantial inheritance-tax savings in the estates of the beneficiaries.

The *irrevocable* trust (a trust that the owner cannot terminate) is most useful in estate planning because it can reduce death taxes. It can remove property from an estate and still insure that the property will be devoted to the benefit of persons selected by the owner. For example, an owner could transfer property in trust for his son with remainder to his grandson. The property would not be included in the father's estate (unless the three-year-contemplation-of-death rule applied) or in the son's estate, and would pass automatically to the grandson at the son's death. The gift-tax law would apply, however, when the father placed the property in trust; and if the value of the property exceeded the gift-tax exemption, a tax would be due.

Irrevocable trusts cannot be altered, amended, or revoked. For this reason, an irrevocable trust must be drawn very carefully to anticipate all changes that may occur subsequent to its execution.

## USES OF THE TRUST

Here is a list of situations in which a farmer should consider using a trust.

1. When he wants to be relieved of the burden of management.
2. When it is desirable to place title

to several tracts in the hands of one person for ease of management, sale, or distribution at death, and avoid partition by heirs.

3. When an heir (wife or child, for example) has little or no management ability or no knowledge of farming.

4. When minors would be heirs.

5. When the estate is subject to inheritance and estate taxes and a reduction in the tax burden is wanted.

6. When gifts of personal property are to be made to children or grandchildren (as, for example, for an educational fund).

7. When a person owns farmland in another state and wants to provide for its management and inheritance.

8. When it is desired to avoid probate proceedings on part or all of the estate.

9. When there might be a conflict between a life tenant and remainderman (the person who takes the remainder interest after the death of the life tenant) if a life estate were used.

10. When heirs live a considerable distance from the farm, making it difficult to give any personal attention to management.

11. When a second marriage is contemplated, and a present transfer to children of the first marriage is desired.

Notice that the word "management" is used in describing almost half of these situations. If a trust is established to obtain or continue good management, it is important to select a trustee who can provide such management.

Under certain conditions, the trustor may want to

retain management functions or allow the beneficiaries to manage the property. In fact, the trust agreement can provide that the trustee's only responsibility is to hold title and to mortgage or transfer title at the request of the trustor or the beneficiaries. When real estate is involved, this is called a "land trust" in some areas of the state.

**Title is protected in the hands of the trustee.** It cannot be splintered through inheritance or placed in a legal jacket because some or all of the heirs are children. The trustee can be given the legal powers of an owner, and can transfer title, mortgage the property, sign leases for farming or drilling for oil, or assume any other power that the owner (trustor) chooses to give him.

To keep title intact and allow a transfer of the beneficiaries' interests in the trust at the same time, some trustees have issued certificates of ownership. Authority to issue certificates must be given to the trustee in the trust agreement. This procedure is not widely used in Illinois.

**Taxes are always an important consideration** in larger estates. Placing property in an irrevocable trust to reduce the estate, and also the estate of the surviving spouse, is a proper motive, and can result in savings as high as \$25,000 in inheritance taxes on a \$200,000 estate. And since the estate is smaller, probate and estate costs are also reduced.

It is also possible to reduce income tax in some cases by using a 10-year trust. Ask your attorney for information about this special kind of trust.

## **ESTABLISHING A TRUST**

Any trust, whether simple or complicated, should be drafted by an attorney. Setting up a trust also means selecting a trustee. There will be fees for the work of

the trustee unless a member of the family is willing to serve as trustee without compensation.

**The trustee will usually earn his keep** through expert management. For example, placing a farm in trust with a bank that has an outstanding farm-management department will frequently increase the farm's income to such an extent that it will more than pay the fee charge. Similarly, funds placed with a trust company for investment in securities may receive much wiser management and the trust will receive more income. It should also be remembered that trustee fees are tax deductible.

**A trust can be a very useful estate-planning tool**, as well as a means of providing flexibility in carrying out the special wishes of a landowner. Trustee fees are a consideration, however, and there is the possibility that a trustee may not give as much personal attention to the trust as the trustor had hoped for. But in appropriate situations, the trust has many fine features that commend it to the farmer. In many cases, it is possible to personalize a trust by naming a relative or friend as co-trustee, thus removing the objection that a trust is an impersonal relationship.